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FEDERAL COMMUNICATIONS COMMISSION
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Application by SBC Communications, Inc.,
Southwestern Bell Telephone Company, and
Southwestern Bell Communications Services, Inc.
d/b/a Southwestern Bell Long Distance for
Provision of In-Region, InterLATA Services in
Missouri

CC Docket No. 01-88

John Sumpter
Vice President, Regulatory
PacWest Telecom, Inc.
4210 Coronado Avenue
Stockton, California 95204

Dated: May 16, 2001

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SUMMARY

This application presents the fourth state of the five state Southwestern Bell Telephone Company ("SWBT") region in which SWBT has sought Section 271 authority. This application follows on the heels of successful grants in Texas, Kansas and Oklahoma, and SWBT would like nothing more than for this Commission to think that the local exchange market in Missouri is but an extension of the markets that the Commission found to be open to competition in the other states. The record in this proceeding has clearly demonstrated, however, that the Missouri market is not as open to competition, and that there are serious deficiencies in this particular application that warrant denial of the application.

Foremost amongst these issues is that of SWBT's pricing for interconnection and unbundled network elements which is without dispute the highest in SWBT's region. These high rates have been shown to have no basis in any cost differentials between the various states, and demonstrate that the prices fall outside of the range that reasonable application of TELRIC principles would produce. Scrutiny of the cost proceedings that produced many of the rates exposes significant deviations from TELRIC principles which helps explain why the rates are so high. In addition, numerous rates are interim subject to pending cost proceedings. Normally, the existence of pending cost proceedings has helped allay this Commission's concerns about use of interim rates, but the prior history of rate-setting in Missouri provides no confidence that pro-competitive forward-looking rates will result from those proceedings. The high rates SWBT is seeking in those proceedings suggests that excessive rates will continue to exist in Missouri. Each of these factors – high rates, deviation from TELRIC principles and excessive use of interim rates – would counsel independently for rejection of this application; taken together they mandate rejection.

With these high rates, it is no wonder that local competition is limited in Missouri. This heightens concerns that a premature grant of Section 271 authority will ensure that competition will fail to deploy in Missouri. The recent report by the Texas Public Utilities Commission that the residential market is still a monopoly in Texas provides cause for much concern. If a local competition has not taken root in Texas, where there is a much larger competitive presence and more competitive investment in facilities due to lower rates, then the situation does not portend well for Missouri.

This is why PacWest urges that this Commission apply a more substantive public interest standard for Section 271 applications that is applied independently of competitive checklist considerations. PacWest urges that the Commission ensure that the Missouri market is irrevocably open to competition before prematurely granting Section 271 authority. This will ensure that true, viable competition takes root. Such an approach would also accord with the recent request by Senators Burns, Hollings, Inouye, and Stevens that this Commission employ the public interest standard to protect the current, precarious state of competition. Whatever competition there is in Missouri is limited and precarious, and will be imperiled if SWBT is granted Section 271 authority. It would be in the public interest if this Commission denies the application and requires SWBT to demonstrate sustained levels of adequate provisioning at pro-competitive, TELRIC-based rates.

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Application by SBC Communications, Inc.,)
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d/b/a Southwestern Bell Long Distance for)
Provision of In-Region, InterLATA Services in)
Missouri)

**REPLY COMMENTS OF
PACWEST TELECOM, INC.**

PacWest Telecom, Inc. ("PacWest") submits these Reply Comments concerning the above-captioned Application by SBC Communications, Inc., Southwestern Bell Telephone Company, and Southwestern Bell Communications Services, Inc. d/b/a Southwestern Bell Long Distance ("SBC") for Provision of In-Region, InterLATA Services in Missouri filed April 4, 2001 ("Application").¹ For the reasons stated herein, the Application should be denied.

I. SWBT'S UNE PRICING DOES NOT COMPLY WITH CHECKLIST ITEM 2

PacWest's concerns about Southwestern Bell Telephone's ("SWBT") pricing for unbundled network elements has been echoed by numerous parties in this proceeding including other CLECs,² and third-party observers.³ SWBT's attempted showing that it complies with

¹ Comments Requested on the Application By SBC Communications, Inc. for Authorization Under Section 271 of the Communications Act to Provide In-Region, InterLATA Service in the State of Missouri, Public Notice, CC Docket No. 01-88, DA 01-768, released April 4, 2001.

² See, e.g., CC Docket No. 01-88, Comments of AT&T Corp. In Opposition to SBC Communications, Inc.'s Section 271 Application for Missouri at 8-32 (April 24, 2001) ("*AT&T Comments*"); Comments of WorldCom, Inc. on the Application by SBC Communications, Inc. for Authorization to Provide In-Region, InterLATA Services in Missouri at 2-13 (April 24, 2001) ("*WorldCom Comments*"); and Comments of Sprint Communications Company L.P. on Southwestern Bell's Section 271 Comments at 3-10 (April 24, 2001) ("*Sprint Comments*"); Comments of McLeod USA Telecommunications Service, Inc. (April 24, 2001).

Commission guidelines concerning pricing is plagued by three problems – high rates, nonconformance with TELRIC principles, and extensive use of interim prices. Each of these problems, in and of itself, would counsel for rejection of the Application; together, they leave no other choice for this Commission than to reject the Application.

A. High Rates

The permanent UNE recurring charges set in Missouri exceed by a significant margin the rates set in other states in the SWBT region.⁴ Prices for unbundled switching exceed the prices in Texas and Kansas by 22 and 60% respectively.⁵ Prices for loops are 20% higher than those in the other SWBT states.⁶ Permanent nonrecurring charges are also significantly higher than those in other states in SWBT's region.⁷ The situation gets even worse when one examines the interim rates set in Missouri PSC Docket No. 98-115. The interim recurring and nonrecurring charges set in this docket exceed the rates set in Texas, Kansas and Oklahoma by two to six times for the recurring charges and two to thirteen times for the nonrecurring charges.⁸

To determine whether rates are “outside the range that the reasonable application of TELRIC principles would produce,” this Commission has recently undertaken comparisons of rates in the applicant's state to rates the Commission has previously found to be TELRIC-compliant in another state.⁹ As the Commission noted:

³ CC Docket No. 01-88, Evaluation of the United States Department of Justice at 7-20 (May 9, 2001) (“*DoJ Evaluation*”); Comments of the Missouri Office of the Public Counsel at 12-13 (May 3, 2001) (“*MO Public Counsel Comments*”).

⁴ *DoJ Evaluation* at 10.

⁵ *Id.*

⁶ *Id.*

⁷ *Id.*

⁸ *Id.* at 12.

⁹ *Joint Application by SBC Communications, Inc., Southwestern Bell Telephone Company, and Southwestern Bell Communications Services, Inc. d/b/a Southwestern Bell Long Distance for Provision of In-Region, InterLATA Services in Kansas and Oklahoma*, CC Docket No. 00-217, Memorandum Opinion and Order, FCC 01-29, ¶ 81 (Jan. 22, 2001) (“*SWBT KS/OK 271 Order*”).

In making such a determination, we agree with the Department of Justice that we may, in appropriate circumstances, consider rates that we have found to be based on TELRIC principles. We therefore compare SWBT's rates in Oklahoma to SWBT's rates in Texas. We do so because they are adjoining states; because the two states have a similar, if not identical, rate structure for comparison purposes; and because we have already found the rates in Texas reasonable.¹⁰

In regard to this Application, since rates in not only Texas, but also Kansas and Oklahoma have been found to be based on TELRIC principles, comparisons to rates in all three of these states are appropriate.

In evaluating the rates, the Commission will look to see if the rate differential between the states is based on different costs between the states. If not, there is a strong indication that the rates are not TELRIC-based.¹¹ The Commission has found that its USF cost model provides a reasonable basis for comparing cost differences between states. The Commission noted that while the USF cost model should not be relied upon to set rates for UNEs, it accurately reflects the relative cost differences among states.¹²

The Department of Justice has concluded in conducting such a comparison that:

[a] comparison of USF costs for Missouri with those of Texas and Kansas, however, suggest that the difference in the tariffed prices described above exceeds any cost differences between the states. The comparison of Missouri and Kansas is particularly telling as these are adjacent states with nearly identical costs, according to the USF model.¹³

For instance, in Missouri, the average loop rates are 20 to 25% higher than in Kansas, and the average switch rates are 50% higher than in Kansas. Under the Commission's Model, Missouri's loop costs should be \$1.35 lower than in Oklahoma, but are actually \$1.28 higher.¹⁴

¹⁰ *Id.* at ¶ 82.

¹¹ *Id.* at ¶ 84.

¹² *Id.*

¹³ *DoJ Evaluation* at 13.

¹⁴ *AT&T Comments* at 9. AT&T noted that SWBT's loop rates in Oklahoma just barely met the Commission's standards. *Id.*

This unexplained cost disparity is seen in regard to nonrecurring charges as well. Sprint found that the non-recurring charges in Missouri for certain UNEs were often 100% to 200% higher than corresponding UNE charges in other states, and in one case was 469% higher.¹⁵ These non-recurring charges were higher despite the fact that Missouri had the lowest labor charges in the region, and labor charges are generally the most significant cost driver in nonrecurring charges.¹⁶

Thus, there are significant disparities between the rates in Missouri and those in the other SWBT rates. The fact that the rates in Missouri are much higher and are not explained by the relative cost differentials between the states clearly suggests that SWBT's rates in Missouri fall outside of the TELRIC range.

B. Inappropriate Application of TELRIC Principles

This Commission has determined that "prices for unbundled network elements (UNEs) *must* be based on the total element long run incremental cost (TELRIC) of providing those elements."¹⁷ PacWest has noted significant instances where SWBT's prices for UNEs deviate from TELRIC. As the Department of Justice concluded, "a review of its [Missouri PSC] decisions on several key questions of method and inputs raises a number of questions as to compliance with forward-looking cost principles."¹⁸

In regard to switching, WorldCom notes that Missouri is the first PSC to use only the discounts SWBT receives on purchases of growth switches for considering switching costs as

¹⁵ *Sprint Comments* at 9. Sprint did a comparison of nonrecurring charges for certain digital loops, DS1 trunk ports, multiplexing, and SS7/Links Cross Connects. *See also* McLeodUSA Comments at 31.

¹⁶ *Id.*

¹⁷ *SBC KS/OK 271 Order* at ¶ 47. (emphasis added).

¹⁸ *DoJ Evaluation* at 14.

opposed to considering initial switch discounts as well.¹⁹ This exclusion inflates the cost of switching “significantly” and does not fully reflect the discounts that SWBT receives.²⁰ While these discounts are a “key lever” in the development of forward-looking switching costs, there were also other significant errors such as basing the “hardware” factor²¹ on old technology (thus, overstating costs) and double-counting of maintenance port costs.²²

In regard to loop costs, SWBT used its actual, historical fill factors as opposed to forward-looking fill factors.²³ The Missouri PSC noted that these fill factors were inappropriate, but only adjusted them to 40% which is substantially lower than the fill factors previously sanctioned by this Commission.²⁴ The Commission in Oklahoma held that a 39% fill factor was too low, finding “that a fill factor that assumes that more than two-thirds of capacity is idle for an indefinite time is unreasonably low.”²⁵ The Commission noted that fill factors ranging from 50 to 75% were more appropriate.²⁶

SWBT’s depreciation factor also deviates from forward-looking principles. Its asset lives are “significantly” shorter than those used by the Missouri PSC, in other proceedings, and those used by other state commissions.²⁷ SWBT uses financial depreciation lives rather than economic depreciation lives that is required by the Commission.²⁸ As AT&T notes, the “use of financial accounting lives significantly inflated all of SWBT’s permanent UNE rates.”²⁹ As the

¹⁹ *WorldCom Comments* at 7.

²⁰ *Id.*; *DoJ Evaluation* at 14.

²¹ The “hardware” factor tracks SWBT’s investment in switch-related investment. *WorldCom Comments* at 8.

²² *DoJ Evaluation* at 15; *WorldCom Comments* at 8.

²³ *DoJ Evaluation* at 15;

²⁴ *DoJ Evaluation* at 16; *WorldCom Comments* at 10; *AT&T Comments* at 21 (Noting that “no distribution fill factor of less than 50% can be justified as forward-looking.”).

²⁵ *SBC KS/OK Order* at ¶ 81.

²⁶ *Id.*

²⁷ *DoJ Evaluation* at 16.

²⁸ *AT&T Comments* at 16.

²⁹ *Id.* at 17.

Department of Justice observed, “the record does not reflect any determination of whether the benchmark range of rates was consistent with forward-looking principles or was a reflection of financial depreciation rates.”³⁰

Given these significant deviations from TELRIC principles, it is no wonder that SWBT’s rates fall outside the range that the reasonable application of TELRIC principles would produce.

C. Excessive Use of Interim Rates

As noted in the initial Comments, the Commission has allowed limited use of interim rates.³¹ Several commenters concur that in regard to SWBT’s Missouri pricing, SWBT is seeking to have the exception swallow the rule.³² As Sprint notes, the extent of interim rates in Missouri is unprecedented.³³

Some of the UNE rates have been interim since December 1997. The Department of Justice was particularly concerned about these rates as they are “troublingly high and have been left as interim for years, despite concerns having been raised that the rates were not forward-looking.”³⁴ In addition, there are interim rates for 95 UNEs as well as loop conditioning, line sharing, and collocation that have been imported from Texas without any substantive review by the Missouri PSC.³⁵ As AT&T notes, “scores of UNE charges were based on equally flawed SWBT cost studies that have never even been reviewed by the MPSC or were imported

³⁰ *DoJ Evaluation* at 17.

³¹ CC Docket No. 01-88, Comments of El Paso Networks, LLC and PacWest Telecom, Inc. at 11 (April 24, 2001).

³² *Sprint Comments* at 4-8; *AT&T Comments* at 27; *DoJ Evaluation* at 19; *McLeodUSA* at 29.

³³ *Sprint Comments* at 5, citing, *Southwestern Bell Telephone Co. v. Missouri Public Service Commission*, 236 F.3d 922 (8th Cir. 2001). Staff of the Missouri PSC recognized that this court decision “created uncertainty as to the future of these prices.” *Id.* at 6.

³⁴ *DoJ Evaluation* at 19.

³⁵ *Sprint Comments* at 6-7.

wholesale from Texas with no attempt to assess the reasonableness of their application to Missouri.”³⁶

The Commission should not sanction such an extensive reliance on interim rates. As the Commission has noted:

[w]e believe that this question should be addressed on a case-by-case basis. If the uncertainty caused by the use of interim rates can be minimized, then it may be appropriate, at least for the time being, to approve an application based on the interim rates contained in the relevant tariff. Uncertainty will be minimized if the interim rates are for a few isolated ancillary items, permanent rates that have been established are in compliance with our rules, and the state has made reasonable efforts to set interim rates in accordance with the Act and the Commission’s rules.³⁷

There is far too much uncertainty in regard to SWBT’s Missouri rates. This Application shows the manifest danger in relying too much on interim rates. There has not been a sufficient record of permanent UNE rates based on TELRIC principles to demonstrate that SWBT’s rate structure meets the checklist requirements.

D. The Commission Should Reject the Application Based on These Pricing Issues

The Department of Justice concluded that “the continued uncertainty of so many rates, coupled with the doubts about pricing discussed *supra*, gives rise to doubts that the market is open to competition by firms that seek to use these elements.”³⁸ The effect of the high and largely interim rates is seen in the lack of UNE-based competition³⁹ and residential competition.⁴⁰

³⁶ *AT&T Comments* at 27.
³⁷ *BANY 271 Order* at ¶ 258.
³⁸ *DoJ Evaluation* at 19.
³⁹ *DoJ Evaluation* at 6.
⁴⁰ *AT&T Comments* at 1.

The Missouri PSC, clearly recognizing the problematic nature of SWBT's pricing, seeks to allay the serious concerns by noting that it is moving "expeditiously" to determine permanent rates.⁴¹ Given the high rates in Missouri and the deviations from TELRIC-principles quick action by the Missouri PSC does not provide any assurance that they will implement pro-competitive rates in Missouri. The fact that SWBT, in these proceedings, are seeking even higher rates does not suggest that the situation will improve.⁴²

This Commission should reject SWBT's Application because it fails to make the necessary showing in regard to Checklist Item 2. The UNE rates in Missouri are far too high, too interim in nature, and deviate significantly from TELRIC principles. If, in fact, the Missouri PSC is attempting to address the situation, the solution is to reject the Application until the Missouri PSC sets permanent rates in the pending dockets that comply with TELRIC principles and fall within the appropriate TELRIC range. Until such prices are implemented, SWBT will remain in noncompliance with Checklist Item 2.

II. GRANTING SWBT'S APPLICATION WOULD NOT BE IN THE PUBLIC INTEREST

In their initial comments, PacWest urged that the Commission reject SWBT's overtures that the Commission reduce consideration of the public interest standard to no more than consideration of the overall checklist compliance. Instead, the Commission should continue to apply the public interest standard as a separate substantive requirement that must be met before Section 271 authority is granted.⁴³ In particular, PacWest requested that the Commission focus

⁴¹ CC Docket No. 01-88, Written Consultation of the Missouri Public Service Commission at 1 (April 4, 2001).

⁴² *AT&T Comments* at 11; *McLeodUSA* at 30.

⁴³ *Comments* at 27-31.

on whether the Missouri market is open to competition, and whether it will remain open to competition.

PacWest's call for a more stringent application by the Commission of public interest standard was recently echoed by Senators Burns, Hollings, Inouye, and Stevens in a letter to Chairman Powell.⁴⁴ In that letter the Senators stated:

[t]he public interest requirements were added to Section 271 to ensure that long distance authority would not be granted to a Bell company unless the commission affirmatively finds it is in the public interest. Meaningful exercise of that authority is needed in light of the current precarious state of the competitive carriers which is largely due to their inability to obtain affordable, timely, and consistent access to the Bell networks.⁴⁵

PacWest urges that even if this Commission finds that SWBT's Application is minimally compliant with the competitive checklist, the Commission consider whether the Application truly is in the public interest.

In this connection, the Commission should consider whether the Missouri market is irrevocably open to competition. If the market is not truly open to competition, then the dangers in a premature grant of Section 271 authority are manifest. For instance, as AT&T has noted, the Texas Public Utilities Commission in a report delivered to the Texas legislature this year concluded that six months after SBC obtained Section 271 authority in Texas, "monopoly power exists . . . in residential and rural markets in Texas."⁴⁶ The Texas PUC also found that this situation is likely to persist. The granting of premature Section 271 authority only makes the

⁴⁴ Letter from Senators Conrad Burns, Ernest F. Hollings, Daniel K. Inouye, Ted Stevens to The Honorable Michael K. Powell, Chairman, Federal Communications Commission (April 17, 2001) ("*Senators' Letter*").

⁴⁵ *Id.* at 3.

⁴⁶ *AT&T Comments* at 2.

situation worse because SWBT's ability to offer "one-stop shopping for local and long distance services" will effectively insulate it from competition.⁴⁷

Competition in the state of Missouri is in a precarious state. Only 1.31% of residential lines in Missouri are served by facilities-based competitors.⁴⁸ There are only 4,500 CLEC DSL lines in Missouri.⁴⁹ There also "is less competition by firms seeking to use UNEs."⁵⁰ Only 5.10% of business lines are served by CLECs, and only 1.78% of the total amount of lines are served by CLECs.⁵¹ There are also "indications that a failure by SBC to satisfy all of its obligations may have constrained this type [UNE-based] competition."⁵² This is exactly the type of limited competition that will be trampled by a premature grant of Section 271 authority in Missouri. As AT&T observed:

[T]hus, granting a 271 application at this time would simply permit SWBT to leverage its existing monopoly over local residential service into bundled packages of local and residential service – creating precisely the harms to consumers and the public interest that Section 271 is designed to prevent.⁵³

Since the levels of CLEC penetration in other service areas in Missouri is also so low, these areas would be vulnerable as well. The situation in Missouri presents exactly the type of situation that concerned Senators Burns, Hollings, Inouye, and Stevens. As they noted:

[T]he deregulation of the Bell companies envisioned by the Act is predicated on the existence of a competitive local marketplace – which does not exist today. If present trends continue, local markets will not be open to competition and incumbent companies will leverage their monopolies as they enter new service areas. They will dominate the highly competitive long distance and information

⁴⁷ *Id.* at 2-3.

⁴⁸ *Id.* at 1.

⁴⁹ *DoJ Evaluation* at 6.

⁵⁰ *Id.*

⁵¹ *AT&T Comments* at 57.

⁵² *DoJ Evaluation* at 7.

⁵³ *AT&T Comments* at 55.

service industries – not as a result of greater efficiency, but solely because of their control of the last mile facilities essential for competitors to reach consumers.⁵⁴

There is every indication that it is premature to grant SWBT Section 271 authority in Missouri. In addition to the pricing and provisioning concerns raised by commenters in their Comments and Reply Comments, it is also inescapable that as recently as February 13, 2001, the Missouri PSC was poised to refuse to endorse SWBT's Application. As the Missouri Office of the Public Counsel noted, it was undisputed as of February 13, 2001 that SWBT was not in compliance with four of the checklist items including the requirements as to pricing.⁵⁵ SWBT made some Missouri PSC-designated modifications to the M2A to attempt to come into compliance with the remaining checklist items.

The Office of the Public Counsel noted that the next step would have been to “see the agreement in place under operational conditions for a sufficient period of time prior to the PSC voting on final approval.”⁵⁶ Under such a monitoring period, “performance, not promises would become the focus of the evaluation to determine whether SWBT had indeed opened up its local market irrevocably to competition.”⁵⁷ In fact, both the Missouri PSC and SWBT contemplated that such a period would be implemented.⁵⁸ Instead, a sudden and abrupt about-face occurred, and no evaluation was made as to whether the M2A would redress the effects of years of SWBT anticompetitive practices. As the Public Counsel observed, “the actual finding that SWBT operates and continues to operate under the Section 271 compliant M2A was not made and in fact could not have been made.”⁵⁹

⁵⁴ *Senators' Letter* at 1.

⁵⁵ *MO Office of the Public Counsel Comments* at 10.

⁵⁶ *Id.*

⁵⁷ *Id.*

⁵⁸ *Id.*

⁵⁹ *Id.* at 11.

It would be in the public interest to require that SWBT's grant of Section 271 authority be supported by sustained performance and compliance with the market-opening mandates of the Act rather than promises to perform.⁶⁰ In Missouri, given the history of SWBT's high prices and anticompetitive practices documented in this proceeding it would be prudent to see if the use of the M2A coupled with the outcome of the pending cost dockets before the Missouri PSC allow for the development of viable competition in Missouri.

PacWest is especially wary of SWBT's representations and promises given its recent admission that sworn affidavits it filed in CC Docket No. 00-217 contained "inaccurate" information as to how loop qualification information is provided.⁶¹ What is troubling about this letter is that it appears in their rush to get the Kansas/Oklahoma applications approved, SWBT personnel hastily prepared affidavits containing this "inaccurate" information instead of conducting a thorough analysis to ensure they gave an accurate response that addressed the issue raised by CLECs. SWBT admitted that the personnel who gave the information to the affiants "were mistaken in their understanding of how LFAC works."⁶² Since loop qualification was a big issue in the KS/OK proceeding, and LFAC, is the main database for loop qualification, one would have hoped that SWBT personnel were more attuned to how the database works, or at least attempted to become more attuned. It is particularly troubling that this "discovery" occurred only after SWBT obtained its much-desired Section 271 authorization in those states.

Instances such as this underscore the importance of resisting a rush to grant Section 271 authority. There are serious issues concerning SWBT's Application. The Commission should not rely on SWBT's promises and representations. Instead, the Commission should reject the

⁶⁰ See McLeodUSA at 14.

⁶¹ CC Docket No. 00-217, Letter from Edwardo Rodriguez, Jr., Director, Federal Regulatory, SBC Communications, Inc. to Magalie R. Salas, Secretary, FCC at 3 (April 13, 2001).

Application and require SWBT to demonstrate that it has made a firm commitment to pro-competitive pricing and provisioning. Once it has demonstrated that commitment based on substantial performance over a reasonable period of time, it can reapply. Until then, this Application is premature, and granting this Application would not be in the public interest as it would imperil whatever limited competition there is in the State of Missouri.

III. CONCLUSION

For the foregoing reasons, PacWest Telecom, Inc. urges the Commission to deny SBC's Application for Provision of In-Region InterLATA Services in Missouri.

Respectfully submitted,



John Sumpter
Vice President, Regulatory
PacWest Telecom, Inc.
4210 Coronado Avenue
Stockton, California 95204

Andrew D. Lipman
Patrick J. Donovan
Harisha J. Bastiampillai
Swidler Berlin Shereff Friedman, LLP
3000 K Street, N.W., Suite 300
Washington, D.C. 20007
(202) 424-7500 (Telephone)
(202) 424-7643 (Facsimile)

Counsel for
PacWest Telecom, Inc,

Dated: May 16, 2001

CERTIFICATE OF SERVICE

I, Deborah A. Walker, hereby certify that on May 16, 2001, I caused to be served upon the following individuals the Reply Comments of Pacwest Telecom, Inc. in CC Docket No. 01-88:

BY COURIER:

Magalie Roman Salas, Esq.
Secretary
Federal Communications Commission
445 12th Street, SW, TW-B204
Washington, DC 20554

Dana K. Joyce, General Counsel
Missouri Public Service Commission
P.O. Box 360
Jefferson City, MO 65102

Janice Myles
Common Carrier Bureau
Federal Communications Commission
445 12th Street, SW, Room 5-C327
Washington, DC 20554
ATTN: Docket No. 01-88

Michael K. Kellogg
Geoffrey M. Klineberg
Kellogg, Huber, Hansen, Todd
& Evans, P.L.L.C.
1615 M Street, NW, Suite 400
Washington, D.C. 20036

International Transcription Services, Inc.
445 12th Street, SW, Room B-402
Washington, DC 20554

James D. Ellis
Paul K. Mancini
Martin E. Grambow
Kelly M. Murray
Robert J. Gryzmala
John S. Di Bene
John M. Lambros
Counsel for SBC Communications Inc.
175 E. Houston
San Antonio, TX 78205

BY OVERNIGHT COURIER:

Layla Seirafi
U.S. Department of Justice
Antitrust Division
Telecommunications Task Force
1401 H Street, NW, Suite 8000
Washington, DC 20005

BY FIRST CLASS MAIL:

Alfred G. Richter, Jr.
Counsel for Southwestern Bell Telephone
Company
175 E. Houston, Room 1250
San Antonio, TX 78205

Paul G. Lane
One Bell Center, Room 3520
St. Louis, MO 63101
Counsel for Southwestern Bell Telephone
Company

Deborah A. Walker